ROCKPORT ANALYTICS

San Mateo County Travel Taxes:
Tax Impact Analysis of Proposed Measures T & U

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Key Highlights

- The San Mateo County Board of Supervisors has proposed two ballot measures that would add a 2.5% tax on rental cars and increase the occupancy tax paid on hotel rooms from 10% to 12%.
- Taxes on both rental cars and hotel rooms are already significantly higher than those imposed on other goods and services – the total tax burden on rental cars in San Mateo County is currently 51.7%[1] and would be raised to 54.2% under Ballot Measure T; the effective rate on hotel rooms is currently 13.2% and would be 15.2% if Ballot Measure U were passed.
- The rental car tax burden at San Francisco International is the third highest among the country's major metro airport locations; the proposed tax increase would push SFO to number two.
- The Board estimates the two measures would bring in a combined $7.7 million in annual tax revenue to San Mateo County, but our analysis shows that the actual revenues raised will fall far short of this number.
- The Board's analysis does not account for the negative economic effects of increasing tax rates on rental cars and/or hotel rooms and weakening consumer demand, including:
    - A tax-induced increase in the effective price of a daily rental resulting in an estimated annual reduction of 104,800 daily contracts. This would lead to a decrease of $3.7 million in expenditures and $2 million in tax revenue.
    - A reduction in the number of hotel room nights, which would lead to a decrease of $62,884 in expenditures and $7,546 in tax revenue.
    - Lower demand for hotel rooms in San Mateo County will lead to lower demand of other goods and services typically purchased by travelers, including restaurant meals, shopping, transportation, and entertainment.

[1] Total assumes a 2-day car rental and combines car rental transaction taxes with taxes levied on car rental businesses.

- o There are also negative knock-on effects that would result from these direct and ancillary spending losses, much of which would accrue in San Mateo County.

- ➢ The Board overestimates the tax revenues that will be generated by these measures because it fails to take into account the significant reduction in demand caused by higher taxes. In total, if both measures were to pass, there would be an offset in tax revenue of $2.8 million, $2.4 million of which are state and local tax receipts. This means the Board's projection is off by nearly one-third (31%).

Background

The San Mateo Board of Supervisors has proposed three separate tax measures – Ballot Measure T, Ballot Measure U and Ballot Measure X – which will be placed on the June 5th Ballot in San Mateo County, CA. This analysis looks at the economic impact of two of those ballot measures – Measure T and Measure U.

Measure T and the corresponding ordinance would authorize the County to levy a business license tax on operators of vehicle rental businesses in the unincorporated area of the County. The tax would be imposed at the rate of two-and-a-half percent (2.5%) on the gross rental receipts of vehicle rental businesses in the unincorporated area. All gross receipts collected on or after July 1, 2012, would be subject to the tax. Measure U and the corresponding ordinance would authorize the County to increase the existing tax levy from ten percent (10%) to twelve percent (12%) on any individual who, for up to 30 consecutive days, occupies or is entitled to occupy a hotel room or other lodging for dwelling, lodging, or sleeping purposes. The existing tax applies to occupancy in any hotel, motel, lodging house, apartment house, mobile home or house trailer at a fixed location, or other lodging.

The proceeds of both the occupancy tax increase and the business license tax would be placed in the County's general fund to support general County services and functions. The San Mateo Board of Supervisors estimates that the combined tax revenue generated from the two measures would equal $7.7 million annually.

However, the Board's fiscal analysis fails to account for decreases in demand that would accompany higher prices caused by new taxes on both rental car businesses and hotel rooms in the area around SFO. These lower levels of demand would offset total tax collections to a certain degree, as decreased demand would lower the tax base for both rental cars and hotel rooms.

Additionally, there would be a reduction in ancillary spending that would occur given a lower level of demand for hotel rooms in San Mateo County. For example, travelers who choose to either shorten their trip, stay outside of the area of the proposed tax hike, or not travel at all would have spent money on other goods and

services in San Mateo County such as restaurant meals, retail goods, and entertainment. Lastly, lower levels of demand for hotel rooms and rental cars would lead to lower demand for the supply chains of the impacted industries as well as lower levels of income that would have been spent in the San Mateo economy.

San Mateo Travel Tax Landscape

In order to provide perspective on these proposed measures, we have surveyed the landscape of travel taxes in San Mateo County, specifically the area around San Francisco International Airport (SFO), along with the surrounding tax jurisdictions in San Francisco City, the area around Oakland International Airport (OAK), and the area around San Jose International Airport (SJC). Further, we have done a comparative analysis of the travel tax burden in other key U.S. travel destinations.

The tables below summarize the total tax burden borne by consumers renting a car across different destinations. The total tax burden for a rental car transaction in San Mateo County is 51.7%, which would be raised to a total of 54.2% in the event that Ballot Measure T were implemented. The estimated tax burden includes all tax rates and fees and assumes a two-day car rental (i.e., rental fees are divided by the average rate and then divided by 2). San Mateo currently has the third largest tax burden among the major metro areas listed in the table below; should the proposed Measure T pass, San Mateo would move to number two.

Car Rental Taxes and Fees by Location

City	Car Rental Total Tax Burden	Car Rental Tax Rate	Car Rental Airport Tax Rate	Fees (per rental)	Fees (per day)	Sales Tax Rate (Composite)
Chicago (ORD)	59.6%	12.00%	10.00%	2.75	9.00	9.75%
San Mateo (SFO) Proposed	**54.2%**	**6.00%**	**11.10%**	**20.00**		**8.50%**
Boston (BOS)	53.8%	0.00%	11.10%	10.00	7.75	6.25%
San Mateo (SFO) Current	**51.7%**	**3.50%**	**11.10%**	**20.00**		**8.50%**
Dallas (DFW)	41.4%	0.00%	11.10%		5.35	8%
San Jose (SJC)	40.0%	3.50%	11.10%		6.00	8.25%
Oakland (OAK)	38.4%	3.50%	11.10%	10.00		9.50%
Los Angeles (LAX)	37.5%	2.85%	11.10%	10.00		9.75%
Denver (DEN)	34.6%	0.00%	11.10%		3.60	4.10%
Washington, DC (BWI)	30.5%		11.10%		5.50	6.00%
New York City (EWR)	30.2%	12.00%	11.10%		5.00	8.875%
Orlando (MCO)	29.4%	0.00%	10.00%		4.50	6.50%
San Francisco	8.8%	0.00%				8.75%

Source: Rockport Analytics

Currently, those staying in hotels in the affected area of the proposed tax hike in San Mateo County are paying an effective tax rate of 13.2%; this total tax burden would rise to 15.2% in the event that Ballot Measure U were implemented. San Mateo is currently competitive with other area tax rates. But the 2% hike would push San Mateo's tax burden above that of both Oakland International Airport and San Jose International Airport and make hotels in the unincorporated area of San Mateo County less competitive.

Hotel Taxes and Fees by Location

City	Hotel Room Total Tax Burden	Hotel Tax Rate Composite	Hotel Fee
New York City (JFK)	16.5%	15.00%	3.50
Chicago (ORD)	16.4%	16.40%	
San Francisco	15.6%	14.10%	1.50%
Los Angeles (LAX)	15.5%	15.50%	
San Mateo (SFO) Proposed	**15.2%**	**12.00%**	**3.75**
Dallas (DFW)	15.0%	15.00%	
San Jose (SJC)	15.0%	14.10%	1.00
Denver (DEN)	14.9%	14.85%	
Boston (BOS)	14.5%	14.45%	
Oakland (OAK)	14.1%	14.10%	
San Mateo (SFO) Current	**13.2%**	**10.00%**	**3.75**
Washington, DC (BWI)	13.0%	13.00%	
Orlando (MCO)	12.5%	12.50%	

Travel Taxes Affect Demand

The Board of Supervisors estimates that the proposed ballot measures would have the following fiscal impacts:

- Measure T: The 2.5% tax levied on gross rental car receipts would result in an additional $7.5 million in annual revenue to the County.

- Measure U: The proposed 2% hike in the occupancy tax would generate an additional $200,000 in annual revenue to the County.

The Board's estimates, however, assume that these tax increases would have no impact on the level of consumer demand for rental cars or hotel rooms in the impacted area. In reality, these proposed tax hikes would effectively raise the price that consumers pay to rent a car or book a hotel room. The degree to which demand will be impacted depends on how price sensitive consumers are with respect to these goods and services, or in other words, their price elasticity.

Generally, the demand for goods and services is either referred to as relatively inelastic (less price sensitive) or relatively elastic (more price sensitive). Those goods and services whose demanded quantity falls by more than 1% when the price increases by 1% are considered to be more elastic. Those whose demand falls less than 1% when price increases 1% are more inelastic.

In order to estimate the elasticity for hotel stays, Rockport Analytics used a pooled time-series regression model that included Smith Travel Research (STR) data for hotel demand and average daily rates (ADR) for a cross-section of city destinations, along with U.S. national accounts data, such as GDP. Additionally, we included a tax dummy variable; this variable allowed us to estimate any additional effects on demand, above those strictly based on price, given a tax hike in a given jurisdiction.

Our research uncovered that hotel rooms are relatively inelastic, i.e., demand is relatively less sensitive to changes in price. However, there is still a significant impact – a price increase of 1% will lead to a decrease in the number of rooms demanded by .237%. Additionally, we found that demand decreases an additional .079% in the period in which the tax hike occurs. This is likely due to an initial instinctive reaction among consumers that affects demand more in the near term.

For rental cars we used reported elasticities from key research studies[2] to derive a conservative estimate. The elasticities ranged from .29 (inelastic) to -3.4 (highly elastic). The elasticity used in this analysis is -.715 – an average of two of the most credible and conservative reported values. This measure is relatively inelastic (less than 1%) but more elastic than hotel rooms. It also falls in line with expectations, given that there are a larger number of available substitutes for rental cars than there are for hotel rooms (e.g., taxis, train, bus, etc.).

The table below uses our known elasticities to analyze the impacts on demand of both rental cars and hotel rooms given the Board's proposed tax increase. Further, it shows how those demand impacts would directly affect state and local tax receipts.

[2] Brattle; Uzaglieva, Menezes

Proposed Tax Increases' Impact on Demand

	Rental Cars	Hotel Rooms
Effective Tax Rate	51.7%	10%
Effective Tax Rate (proposed)	54.2%	12%
Total current daily price + tax	$52.94[3]	$128.05[4]
Total proposed daily price + tax	$53.82	$130.38
Total effective proposed price increase	1.65%	1.82%
Price elasticity	-0.715	(-0.237)-.079
Estimated annual demand (daily rooms/rentals)	8,882,521	85,903
Demand offset from tax increase	-104,792	-540
Decrease in room/rental revenue	-$3,657,225	-$62,884
Decrease in tax revenue	-$1,998,794	-$7,546

The proposed tax increase on rental car businesses would lead to an increase of 1.65% on the average price of a rental car at SFO. This price increase would lead to an estimated decrease in annual consumer demand of 104,800 daily car rentals, $3.7 million in rental car revenue and $2 million in tax revenue.

The proposed tax increase on hotel rooms would lead to an increase of 1.82% on the average price of a hotel room within the unincorporated area of San Mateo County. This price increase would lead to an estimated decrease in annual demand of 540 room nights, $62,884 in hotel revenue and $7,546 in tax revenue.

These impacts were estimated using a broad cross section of U.S. city locations. It should be noted that this elasticity analysis is representative of the average price elasticity for hotels in the U.S. Given the availability of a relatively large number of substitutes for rental cars in the Bay Area, along with a number of competing tax jurisdictions, we expect that the actual impact of the tax increase in San Mateo would be somewhat higher.

Spillover Effects

In addition to the direct revenue offsets that would occur due to a decrease in demand for hotel rooms and rental cars in San Mateo County, there would also be additional impacts that would impact the County's bottom line. The first of these effects would be foregone spending on ancillary goods and services in the County

[3] Rental car industry data

[4] Incorporates the average base price for San Mateo County, Smith Travel Research (STR)

resulting from the decrease in hotel room nights. For example, would-be travelers to San Mateo County who decide to shorten their trip, cancel their trip, or stay in another part of the Bay Area would likely have spent money on other goods and services within the county such as restaurant meals, retail, and entertainment.

Using the aggregated distribution of items that travelers spend money on in the Bay Area[5], we have estimated some of the other foregone spending and subsequent sales tax revenue that would result given passage of the proposed occupancy tax hike. These include expenditure losses of $46,000 in food & beverage, $32,000 in retail, $15,000 in entertainment and $29,000 in other goods and services such as gasoline, parking and other amenities. These total expenditure losses of $121,000 would lead to an estimated loss of $10,000 in sales tax revenue.

Ancillary Spending Effect

	Expenditure losses	Lost tax revenue (state sales tax)
Food & Beverage	-$45,630	-$3,879
Retail	-$31,671	-$2,692
Entertainment	-$14,989	-$1,274
Other*	-$28,765	-$2,445
Total	**-$121,054**	**-$10,290**

The second spillover effect would be the downstream economic impact that would result from the loss of expenditures in San Mateo County on rental cars, hotel rooms, food & beverage, etc. Specifically, these foregone expenditures would result in indirect (supplier) and induced (wage) impacts. Indirect impacts are those that affect the supply chain of impacted industries. For example, a decrease in consumer demand for hotel rooms would lead to a decrease in demand for linen providers. Induced impacts are those brought about by a reduction in wages. For example, a reduction in the incremental wages of rental car desk clerks would lead to less spending on other goods and services in the San Mateo economy.

In order to estimate these impacts we have employed the IMPLAN model for San Mateo County.[6] IMPLAN is a non-proprietary economic model that has fast become the de facto standard for most economic impact assessment in the US. This model is critical to measuring the direct, indirect and induced impacts of San Mateo's proposed tax hike. The table below summarizes the total offsetting economic impact that would occur as a result of the implementation of Measure T and Measure U.

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[5] TNS North America, *Travels America 2009*

[6] Minnesota IMPLAN Group (www.implan.com)

Economic Impact Summary

	Direct	Indirect (supply)	Induced (income)	Total
Lost Expenditures				**-3,841,163**
Lost Economic Impact	-2,299,634	-610,597	-520,776	-3,431,007
Lost Wages	-835,140	-399,862	-274,387	-1,509,390
Lost Jobs	-16	-6	-5	-27
Lost Tax Receipts				**-2,841,165**

Total lost expenditures resulting from the increased tax rates would equal $3.8 million. This includes the foregone rental car revenue and hotel revenue, as well as foregone ancillary spending revenue that would occur due to lower levels of demand.

The total economic impact of these lower levels of demand would amount to approximately $3.4 million, including $2.3 million in direct impact, $611,000 in indirect impact and $521,000 in induced impact.

The total offsetting wage impact would amount to $1.5 million in San Mateo, which would include $835,000 in direct wages, $400,000 in indirect wages and $274,000 in induced wages. Total job loss from the offset would total 27 full time equivalents, including 16 direct jobs, 6 indirect jobs and 5 induced jobs. Offsetting tax collections would total $3.1 million.

The table below summarizes the offsetting tax losses. Approximately $2.4 million of the tax offset would be realized by the County and state combined. This includes $2.4 million in transactional taxes, $229,000 in property taxes, $39,000 in income taxes and $105,000 in licensing, fees and other taxes. Additionally, there would be an offset of $415,000 in federal tax collections.

Fiscal Impact Summary

	Transactional Taxes (Sales & Excise)	Property Taxes	Income Taxes	License, Fees, Corp Prof, Other	Total
State & Local Tax Impact	$(2,053,058)	$(229,328)	$(38,876)	$(104,968)	**$(2,426,230)**
Federal Tax Impact			$(243,019)	$(171,916)	**$(414,935)**
Total Tax Impact	$(2,053,058)	$(229,328)	$(281,895)	$(276,884)	**$(2,841,165)**

Conclusion

Our findings show that there would be a state and local tax offset of $2.4 million against the Board of Supervisors' estimate of $7.7 million in total revenue generated from the proposed ballot measures. Additionally, there would be a loss of $415,000 in federal tax collections. The tax increase would lead to lower demand for County goods and services and would negatively affect a cross section of San Mateo County businesses. While there would be some additional fiscal benefit from the revenue generated from the tax, it could not be estimated as both measures would increase the County's general fund and were not earmarked for a specific purpose.

Moreover, the proposed tax hikes would further increase a tax burden on travelers that is already disproportionately high relative to other destinations. The total rental car tax burden in San Mateo County would jump to the second highest in the country among major metro airport locations.